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No. 86-1366

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

DUQUESNE LIGHT COMPANY, *et al.*,
Appellants,

v.

STATE TAX DEPARTMENT OF WEST VIRGINIA, *et al.*,
Appellees.

On Appeal from the Supreme Court of Appeals of West Virginia

MOTION TO DISMISS OR AFFIRM

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QUESTION PRESENTED

Whether West Virginia's uniform taxation of the generation of electricity within the state for sale (a) "discriminates against out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity" within the meaning of 15 U.S.C. § 391, (b) violates the Commerce Clause, or (c) denies equal protection.

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Appellees State Tax Department of West Virginia and Michael E. Caryl, State Tax Commissioner of West Virginia, hereby move pursuant to Rule 16 of the Rules of this Court to dismiss the appeal in this case or to affirm the judgment below on the grounds that the appeal does not present a substantial federal question and that the questions presented do not warant full briefing and oral argument.

OPINIONS BELOW

The opinion of the Supreme Court of Appeals of West Virginia (J.S. App. C) is reported at 350 S.E. 2d 754

(W. Va. 1986). The opinion of the Circuit Court of Kanawha County (J.S. App. D) is not officially reported. An earlier opinion of the Supreme Court of Appeals in this case (J.S. App. H) is reported at 327 S.E. 2d 683 (W. Va. 1984). The earlier opinion of the Circuit Court (J.S. App. I) is not officially reported.

JURISDICTION

The judgment of the Supreme Court of Appeals of West Virginia was entered on November 30, 1986. Appellants filed a notice of appeal with that Court on February 2, 1987 (J.S. App. A). The jurisdictional statement was filed in this Court on February 17, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant provisions of Article I, § 8, cl. 3 of the United States Constitution and of the Fourteenth Amendment thereto, of 15 U.S.C. § 391 (1982), and of the West Virginia Code are set forth in the Appendix, *infra.*

STATEMENT

1. *Enactment of 15 U.S.C. § 391.* In 1976, as part of the Tax Reform Act of that year, Congress enacted a prohibition against the imposition or assessment of state taxes "on or with respect to the generation or transmission of electricity which discriminate[] against out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity." 15 U.S.C. § 391 (1982). This statute was consciously directed at the New Mexico Electrical Energy Tax Act, an apparently discriminatory state tax that had been enacted by the New Mexico legislature just the year before. 122 Cong. Rec. 24,324-29 (1976). Litigation was promptly brought in state court challenging the New Mexico tax under the new fed-

eral law. On appeal, this Court ruled that the New Mexico tax was invalid by reason of the federal statute. *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979).

2. *The 1978 revision of the West Virginia Code.* Following enactment of 15 U.S.C. § 391, the West Virginia legislature undertook a comprehensive review of existing taxes on the generation of electricity within the state. It found that, unlike the state taxes at which the new federal statute was directed, West Virginia's taxes actually discriminated *in favor* of out-of-state users. Whereas most firms generating and selling electricity within West Virginia were subject to tax at rates ranging from 4.29 to 5.72 percent, firms generating electricity within the state but selling it outside the state were subject to tax at the rate of only 0.88 percent. *See* J.S. App. 32a. The legislature determined to replace that tax structure with a more evenhanded system of taxation under which the rate of tax would be fixed irrespective of the place of sale. It therefore enacted a series of amendments to the West Virginia Code ("the 1978 Act") imposing a uniform tax of four percent on all generation of electricity within the state for sale either within or outside the state. W. Va. Code §§ 11-13-2d and 11-13-2m (1978).[1]

The 1978 Act imposes this tax under two different code sections. Electricity generated within the state by firms qualified to do business within the state as public utilities ("public utilities") and sold in transactions regulated by the West Virginia Public Service Commission ("regulated transactions") is subject to tax under § 11-13-2d ("Section 2d"). Electricity generated within the state by either public utilities or nonutilities for sale in

[1] There are two exceptions to the general rate of four percent. A lower rate of 2.46 percent is imposed on the generation of electricity for sale to high usage manufacturers; electricity generated by municipally owned utilities is exempt. Appellants challenged these exceptions below, *see* J.S. App. 9a-10a n.3, but they have not renewed that challenge here.

transactions not regulated by the Public Service Commission ("unregulated transactions") is subject to tax under § 11-13-2m ("Section 2m").[2] Because Section 2m reaches all electricity generated within West Virginia for sale in unregulated transactions, it applies to electricity sold within as well as outside the state.[3]

Notwithstanding the formal structure of the 1978 Act, which gives the appearance of imposing two separate taxes under two separate code sections, the Act actually imposes a unitary tax on the generation of electricity within the state for sale. The tax is imposed at a uniform rate and is measured by the gross receipts attributable to the activities of generation, transmission, and distribution of electricity, but only to the extent that those activities take place within the state.

Electricity generated, transmitted, distributed, and sold in regulated transactions within the state is subject

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[2] The word "nonutility" is used herein to refer to a firm that is not qualified to do business within West Virginia as a public utility; such a firm may, however, be qualified to do business as a public utility within another state. Similarly, the phrase "unregulated transactions" is used herein to refer to all sales not regulated by the West Virginia Public Service Commission; of course, many of those sales will be subject to regulation in another state.

[3] Section 2m applies when "the sale [of electricity] is not subject to tax under section two-d." In turn, Section 2d applies to "any person engaging or continuing within this state in any public service or utility business" but taxes "only gross income received from the supplying of public services;" it provides that "gross income . . . from any other activity" is to be taxed under some other "appropriate section or sections" of the Code. Thus, when a public utility sells electricity within the state but outside its service area, or a nonutility sells electricity within the state, the transaction is subject to tax under Section 2m rather than Section 2d. *Cf. United Fuel Gas Co. v. Battle*, 167 S.E. 2d 890, 898-902 (W. Va.), *cert. denied*, 396 U.S. 116 (1969). The Supreme Court of Appeals overlooked these applications of Section 2m when it accepted, for purposes of analysis, appellants' erroneous characterization of Section 2m as relating "only to in-state generation or manufacture which is transmitted out of state." J.S. App. 37a.

to tax under Section 2d on the basis of the total "sales and demand charges" for that electricity at the point of sale. In these regulated transactions, "sales and demand charges" represent the costs of generation, transmission, and distribution plus an allowed rate of return. Thus, the tax under Section 2d is based upon a "measurement of value for electricity generated and sold in this State [that] includes not only the cost of manufacturing [*i.e.*, generation] and a reasonable rate of return, but the cost of transporting it to the customer (poles, lines, transformers, etc.) as well." J.S. App. 35a n.9.

Electricity generated within the state but sold in unregulated transactions, whether within or outside the state, is subject to tax under Section 2m on the basis of "gross proceeds," but § 11-13-2 ("Section 2") provides that when the sale occurs outside the state the value of the electricity "immediately before transportation out of the state shall be the basis for the assessment of the tax." Section 2 further provides that "[t]he tax commissioner shall prescribe equitable and uniform rules for ascertaining such value." The State Tax Commissioner has determined that the value of such electricity for purposes of the tax under Section 2m is equal to the cost of generation plus an appropriate rate of return. *See* Stip. Ex. Nos. 16-22.[4] This measure of value does not include the cost of or rate of return on transmission or distribution.

Because of the way the tax imposed by the 1978 Act is measured—*i.e.*, against actual or deemed gross receipts from activities that occur within the state—a firm that generates electricity within the state but transmits and distributes it out of state pays lesser amount of tax on the same volume of electricity than does a firm that generates, transmits, and distributes its electricity within the state. This reflects the legislative determination that firms engaged in not only the generation but also the transmission and distribution of electricity within the

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[4] "Stip. Ex." refers to the Stipulation Exhibits filed in the trial court.

state can fairly be asked to shoulder a larger tax burden proportionate to their more expansive in-state activities.

3. *The course of litigation below.* Appellants are firms that generate electricity in West Virginia and sell all or a portion of that electricity in unregulated transactions either within or outside the state. The 1978 Act ended the preferential tax rate of only 0.88 percent that formerly had applied to electricity generated for sale in unregulated transactions; the Act subjected appellants to tax at the same higher rate of four percent that applies to electricity generated for sale in regulated transactions. Appellants responded to this increase in their tax burden by bringing this case in the Circuit Court for Kanawha County, challenging the 1978 Act on both statutory and constitutional grounds.

a. *Disposition of the statutory issue.* The Circuit Court, without significant analysis, viewed Section 2m in isolation from the remainder of the 1978 Act and held it to be "invalid and unenforceable because it violates 15 U.S.C. § 391." J.S. App. 46a. The Supreme Court of Appeals reversed, observing that "[i]t is quite clear that the 1978 amendments harmonized the tax rate between the generation and sale in this State of electric power and the generation of electric power in this State for transmission out of state." J.S. App. 34a.

The Supreme Court of Appeals specifically rejected the argument that Section 2m must be considered in isolation from the remainder of the 1978 Act:

> we cannot ignore the fact that the 1978 amendments did more than enact Section 2m. . . .
>
> If we consider the 1978 amendments in their entirety, it is apparent that the legislature did not single out and tax only the manufacturing of electricity that is transmitted out of state. Under Section 2d, the manufacturing of electricity that is used in this state is also taxed at the same rate.

J.S. App. 36a. Finding "no discrimination between Sections 2d and 2m," *id.* at 37a, the Court remanded for consideration of the constitutional issues that appellants had raised. *Id.* at 38a.[5] This Court denied appellants' petition for a writ of certiorari. 471 U.S. 1029 (1985).

b. *Disposition of the constitutional issues.* On remand, appellants contended that Section 2m discriminates against interstate commerce in violation of the Commerce Clause and is subject to exemptions and exclusions that have no rational basis and therefore violates the Equal Protection Clause of the Fourteenth Amendment. The Circuit Court rejected these contentions, J.S. App. D, and the Supreme Court of Appeals affirmed. J.S. App. C.

The Supreme Court of Appeals noted that appellants' principal argument under the Commerce Clause, like their earlier argument under 15 U.S.C. § 391, depended upon considering Section 2m in isolation from the remainder of the 1978 Act. The Court concluded that the constitutional argument too must fail, because Section 2m "is but one part of a comprehensive, non-discriminatory, fairly apportioned business and occupation tax." J.S. App. 8a. The Court explained:

> Producers of electricity for distribution inside West Virginia pay a tax of 4 percent on the gross proceeds at the point of final sale. That means that producers of electricity for domestic purposes pay a unified tax under 2d that can be broken down into 4

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[5] Justice Neely elaborated in a separate concurring opinion:

> The only reason that West Virginia taxes generation of power for out-of-state consumption under [Section 2m] and generation for in-state consumption under [Section 2d] is so that out-of-state producers will *not* pay tax on the value of transmission and distribution activities. The tax for in-state consumption is higher than the tax for out-of-state consumption because West Virginia also taxes transmission and distribution for in-state producers.

J.S. App. 42a (emphasis in original).

> percent on the value of manufacture, 4 percent on the value of transmission, and 4 percent on the value of distribution. Producers of electricity for out-of-state distribution pay only a 4 percent tax under 2m on the value of manufacture. The reason that West Virginia taxes generation of power for out-of-state consumption under Section 2m and generation for in-state consumption under Section 2d is so that out-of-state producers will *not* pay tax on the value of transmission and distribution activities. . . .
>
> . . . . The mere fact that it is easier from the point of view of statutory draftsmanship to create a comprehensive, fairly-apportioned tax structure through the use of separate code sections does not, in and of itself, convert what is in fact a single tax on all manufacturers of electricity into a constitutionally invalid tax on the privilege of engaging in interstate commerce.

J.S. App. 10a-11a (emphasis in original).[6]

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[6] The Court dismissed as "without merit" appellants' contention that the lower rate for sales to high usage manufacturers and the exemption for municipally owned public utilities denies equal protection:

> Certainly there is a valid public purpose in distinguishing between ordinary consumers and large commercial users of electricity who provide thousands of jobs in West Virginia or, although located out-of-state, are buying West Virginia power, and can move their plants to locations where their energy needs will not be met by West Virginia power. Furthermore, it is legitimate for the state government to decline to tax the activities of another governmental entity, namely municipally owned power plants. Because it has been conclusively determined that providing power to consumers is a legitimate governmental function, there is no equal protection problem when government declines to tax itself or another government entity.

J.S. App. 9a-10a n.3 (citations omitted).

ARGUMENT

The federal statutory and constitutional issues raised by appellants were fully considered and correctly decided by the Supreme Court of Appeals of West Virginia. Those issues are not substantial and do not warrant full briefing and oral argument in this Court.

A. The 1978 Act Does Not Violate 15 U.S.C. § 391

The 1978 Act does not discriminate against electricity generated within but transmitted, distributed, and sold outside West Virginia. Electricity generated within the state for sale in regulated transactions is taxed at the rate of four percent under Section 2d; other electricity generated within the state for sale—and this includes not only electricity generated for sale outside the state but also electricity generated for sale in unregulated transactions within the state—is taxed at precisely the same rate of four percent under Section 2m. This evenhanded treatment of the generation of electricity within West Virginia quite plainly does not "discriminate[] against out-of-state manufacturers, producers, wholesalers, retailers, or consumers of that electricity" within the meaning of 15 U.S.C. § 391.

Appellants' entire argument to the contrary rests upon a misreading of the 1978 Act and the elevation of form over substance. They contend that Section 2m applies only to the generation of electricity for sale outside the state and therefore is facially discriminatory. But Section 2m does not apply exclusively to electricity generated for sale outside the state; it applies to all electricity generated for sale in unregulated transactions, irrespective of the place of sale. *See* note 3, *supra*. There is no facial discrimination. Neither is there any discrimination as a matter of economic substance. At bottom, appellants' attack on the 1978 Act is a trivial complaint about the fact that, as a matter of form, West Virginia taxes the generation of electricity under two

separate code sections. This division of the tax between two code sections, however, has no substantive significance.

West Virginia for many years has taxed public utilities, including not only electric light and power companies but also street and interurban railways, water companies, toll bridge companies, and other public service or utility businesses, under the umbrella of a single code section. The 1978 Act simply followed this established pattern. It continued the taxation of all public utilities, including those engaged in the generation of electricity within the state, under Section 2d even though different types of public utilities were made subject to tax at different rates.

Perhaps it would have been more logical or orderly for the West Virginia legislature to have taxed all firms engaged in the generation of electricity within the state under Section 2m, especially since all such firms were made subject to tax at the same rate. But the validity of a state law under 15 U.S.C. § 391 cannot turn upon mere statutory placement. Discriminatory taxation is a matter of substance, not form. Because West Virginia imposes the same rate of tax on all generation of electricity within the state for sale, irrespective of the place of sale, it is not guilty of discriminatory taxation and has not violated 15 U.S.C. § 391.

Indeed, West Virginia actually continues to discriminate *in favor* of out-of-state consumers. The tax on electricity transmitted outside the state is measured by the cost of generation plus an allowed rate of return, whereas the tax on electricity generated and sold within the state is measured by not only the cost of generation but also the cost of transmission and distribution, plus an allowed rate of return. Consequently, although the tax is imposed at the uniform rate of four percent on all electricity generated within the state for sale, in practice

it bears more heavily on electricity that is also transmitted, distributed, and sold within the state.

Appellants incorrectly contend that West Virginia's tax on the generation of electricity is no different from the New Mexico tax held invalid in *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979). The two taxes and the two cases are not alike. New Mexico has a general excise tax applicable to the gross receipts from the sale of all commodities including electricity, *see* N.M. Stat. Ann. §§ 7-9-1 to 7-9-82 (1978), but prior to 1975 it had no tax on the generation of electricity. In 1975, New Mexico adopted a tax on the generation of electricity within the state, N.M. Stat. Ann. §§ 7-18-1 to 7-18-6 (1978), but "refunded the tax to domestic producers [who distributed and sold electricity within the state] through a tax credit that applied to an entirely unrelated tax," *i.e.*, the general excise tax. J.S. App. 40a. It was as "if New Mexico had given compensating credits against domestic producers' turnpike tolls or had given them a credit toward the New Mexico vehicle licenses of power company trucks." *Id.* As a consequence, New Mexico's tax on the generation of electricity was borne solely by firms that sold their electricity outside the state.

When New Mexico's electrical energy tax was challenged under 15 U.S.C. § 391, the State argued that "the practical result of its tax structure" was the imposition of an evenhanded tax on the generation of electricity accompanied by an equivalent reduction in the general excise tax (but only to the extent that the latter applied to electricity). *Snead*, 441 U.S. at 150 n.7. Without deciding whether such a selective offsetting reduction in the general excise tax would have made any difference to the outcome, this Court responded that New Mexico had not in fact reduced the general excise tax, *id.*, and that, in any event, "the federal statutory provision is directed specifically at a state tax 'on or with respect

to the generation or transmission of electricity,' not to the entire tax structure of the state." *Id.* at 149. New Mexico's general excise tax applied not only to electricity (whether or not generated within the state) but also to all other commodities offered for sale within the state, even including, for example, "bubble gum." J.S. App. 39a. The excise tax therefore was not a tax "on or with respect to the generation or transmission of electricity" and thus lay outside the analysis called for by 15 U.S.C. § 391. This Court therefore concluded that "[b]ecause the electrical energy tax *itself* . . . discriminates against electricity sold outside New Mexico, it violates the federal statute." 441 U.S. at 150 (emphasis in original).

Unlike the electrical energy tax held unlawful in *Snead*, the tax imposed by Section 2m cannot rationally be considered in isolation for purposes of determining compliance with 15 U.S.C. § 391. Indeed, Section 2m cannot even be read in isolation for purposes of state tax collection. Sections 2d and 2m are intertwined. Section 2m by its terms applies only when "the sale is not subject to tax under section 2-d." Sections 2d and 2m divide between them the taxation of the generation of electricity within the state.

Section 2m imposes a tax at the rate of four percent on electricity generated within the state for sale in unregulated transactions. When the electricity subject to tax under Section 2m is sold in unregulated transactions within the state, the tax applies to the "gross proceeds" from the sale. When the electricity is sold outside the state, Section 2 prescribes that the basis for tax under Section 2m is the value of the electricity "immediately before transportation out of state." Thus, Sections 2 and 2m together impose a tax "on or with respect to the generation or transmission of electricity" within the meaning of 15 U.S.C. § 391.

The parallel provision of Section 2d imposes a tax at the same rate of four percent on electricity generated

within the state for sale in regulated transactions. That provision, like Section 2m, does not cover commodities other than electricity and does not even cover electricity generated outside West Virginia (electricity generated outside but sold within the state is subject to tax at the rate of three percent under a separate provision of Section 2d). Section 2d therefore is very different from New Mexico's general excise tax. Section 2d's tax on the generation of electricity for sale in regulated transactions, like Section 2m's tax on the generation of electricity for sale in unregulated transactions, quite plainly is a tax "on or with respect to the generation or transmission of electricity." Those two parallel and harmonious code sections must be considered together for purposes of analysis under the federal statute.

Under 15 U.S.C. § 391, a state tax is unlawfully discriminatory only "if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce." Sections 2d and 2m do not impose a greater tax burden on electricity sold outside the state than on that sold within the state. They impose precisely the same rate of tax on all electricity generated within the state for sale, whether the sale occurs locally or out of state. The 1978 Act therefore is not discriminatory and does not violate the federal statute.

B. The 1978 Act Is Constitutional

1. *The Act does not discriminate against interstate commerce.* In enacting 15 U.S.C. § 391, Congress was addressing state tax statutes that, although arguably lawful under the Commerce Clause, nevertheless were "properly within the ability of Congress to prohibit through its power to regulate interstate commerce." S. Rep. No. 938, 94th Cong., 2d Sess., pt. I, 437-38 (1976), *reprinted in* 1976 U.S. Code Cong. & Admin. News 3439. *See also* H.R. Conf. Rep. No. 1515, 94th Cong., 2d Sess.,

503 (1976), *reprinted in* 1976 U.S. Code Cong. & Admin. News 4118. This Court recognized that Congress thereby had subjected state taxes to a test at least as strict as, and in all likelihood stricter than, the test prescribed by the Commerce Clause itself. *Snead*, 441 U.S. at 149. It follows that a state "tax on or with respect to the generation or transmission of electricity" which, like the 1978 Act, is lawful under the federal statute *a fortiori* is lawful under the Commerce Clause. Separate constitutional analysis should not be necessary where, as here, Congress has defined the scope of the federal interest in protecting interstate commerce.

In any event, the 1978 Act plainly withstands constitutional scrutiny. "In reviewing Commerce Clause challenges to state taxes, [this Court's] goal has . . . been to 'establish a consistent and rational method of inquiry' focussing on 'the practical effect of a challenged tax.'" *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981) (quoting *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425, 443 (1980)). The practical effect of the 1978 Act is to impose the same rate of tax on all electricity generated within West Virginia for sale, no matter where the sale actually occurs. Because the 1978 Act does not discriminate against interstate commerce, it does not violate the Commerce Clause.[7]

West Virginia's treatment of electricity generated within the state for sale does not "'provid[e] a direct commercial advantage to local business.'" *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977) (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)). Firms generating electricity for sale within the state are granted

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[7] This Court articulated a four-part test for determining the validity of state taxes under the Commerce Clause in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The only prong of that test invoked by appellants, however, concerns discrimination against interstate commerce. They do not dispute that the 1978 Act otherwise satisfies the *Complete Auto Transit* test.

no advantage over firms generating electricity for sale outside the state; they all pay tax at the same rate. Similarly, the 1978 Act does not " 'foreclose[] tax-neutral decisions.' " *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984) (quoting *Boston Stock Exchange*, 429 U.S. at 331). It does not induce firms to sell their locally generated electricity within the state, for they could not reduce either their tax rate or their actual tax burden by doing so. To the contrary, the actual tax burden imposed by West Virginia on local sales is higher, because the tax on such sales is measured not just against the cost of generation, as in the case of sales outside the state, but against the total cost of generation, transmission, and distribution. If anything, therefore, the 1978 Act discourages local sales and encourages interstate commerce. Nothing in the Constitution forbids that.

West Virginia's tax on the generation of electricity is equivalent in all essential respects to Montana's severance tax on coal that this Court upheld in *Commonwealth Edison*. In each case, the taxing state imposed an even-handed levy on a product that is both consumed within and shipped out of state. There are only two distinctions between this case and *Commonwealth Edison*, and neither calls for a different result. *First*, local consumers of coal in *Commonwealth Edison* paid the same amount of Montana tax as out-of-state consumers, whereas in this case, because of the way the tax is measured, local consumers of electricity pay a higher amount of West Virginia tax than do out-of-state consumers. That distinction obviously does not suggest discrimination against interstate commerce. *Second*, the West Virginia tax is imposed under two code sections, rather than under only a single statutory provision as in *Commonwealth Edison*. But this makes no difference under the Constitution. "A state tax must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme." *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981). The actual effect of Sections 2d and 2m, read

together, is to treat alike and evenhandedly all generation of electricity within the state for sale, irrespective of the place of sale.

Appellants label Section 2m a "manufacturing" tax and Section 2d a "sales" tax in an effort to force this case into the mold of *Armco, Inc v. Hardesty*, 467 U.S. 638 (1984). They apparently hope to accomplish through nomenclature that which cannot be justified by analysis. *Armco* involved a gross receipts tax on sales that applied to foreign but not to local manufacturers. The tax on its face violated the rule that "a State may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." 467 U.S. at 642. The State sought to defend the facial discrimination on the ground that local manufacturers were subject to a separate gross receipts tax on manufacturing. This Court concluded that because the two taxes were imposed at different rates and did not have complementary coverages, "[t]he gross sales tax . . . cannot be deemed a 'compensating tax' for the manufacturing tax." *Id.* Consequently, the sales tax on foreign manufacturers was invalid under the Commerce Clause.

This case is materially different. West Virginia is not taxing the generation of electricity more heavily when the electricity flows out of state than when it is consumed locally. All electricity generated within the state for sale is taxed at the same rate. There simply is no discrimination, facial or otherwise. The question of "compensating taxes" therefore need not even arise. It is clear, however, that Section 2m complements Section 2d in much the same way that a use tax complements a sales tax. *See Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). Section 2d taxes electricity generated within the state for sale in regulated transactions; Section 2m taxes, at precisely the same rate, all other electricity generated within the state for sale. Section 2m and the parallel provision of Section 2d therefore are not so much "compensating taxes" as two sides of the same tax coin.

They levy not merely on substantially equivalent events but on precisely the same event—the generation of electricity within the state.[8]

To be sure, the measure of the tax differs depending upon whether the electricity is sold in interstate or intrastate commerce. Under either Section 2d or Section 2m the tax on electricity both generated and sold within the state is measured by the costs of generation, transmission, and distribution, whereas under Section 2m the tax on electricity generated within but sold outside the state is measured only by the cost of generation. This is not discriminatory: interstate and intrastate sellers are treated identically according to their business activities within West Virginia. The practical effect, of course, is that the intrastate seller must pay a higher amount of tax on the same volume of electricity. But this result obviously affords no basis under the Commerce Clause for relieving interstate sellers from the lighter tax burden that they have been asked to carry.[9]

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[8] Appellants incorrectly assert that "the 4% rate [under Section 2d] applies to all public utility sales by an electric utility . . . , including that portion of its sales attributable to electric power it *purchased* from others for resale." J.S. 16 (emphasis supplied). The four percent tax prescribed by Section 2d applies only when a public utility *generates* and sells electricity. When a public utility *purchases* and sells electricity, a different provision of Section 2d prescribes a tax of only three percent. *See* J.S. App. 12a. *Cf. Gilbert Imported Hardwoods, Inc. v. Dailey*, 280 S.E. 2d 260, 265 (W. Va. 1981) ("It is well settled that an integrated business is divisible into its separate parts for the purpose of applying different Business and Occupation Tax rates to its component parts").

[9] Appellants contend that because the resale of purchased power is taxed at three percent, "it is only the 1% difference in rates that could even arguably be attributed to the privilege of generation." J.S. 16. That contention is frivolous. A firm that generates and sells electricity within the state is not subject to a one percent tax on generation plus a further tax of three percent. It pays a tax of four percent applied across the board to the generation, transmission, and distribution of electricity. An intrastate seller therefore pays precisely the same amount of tax for the privilege of

Appellants' contention that the 1978 Act does not meet the test of "internal consistency" prescribed by *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 169 (1983), is erroneous and badly confused. In the first place, the test of "internal consistency" was designed to ensure "that a tax be fairly apportioned to reflect the business conducted in the State." *Armco*, 467 U.S. at 644. It is undisputed that the tax imposed by the 1978 Act is fairly apportioned. In such circumstances, the question of "internal consistency" becomes relevant only if the "tax on its face discriminates against interstate commerce." *Id.* That is not the situation here. Section 2m taxes electricity generated within the state and sold in unregulated transactions, whether within or outside the state, and the parallel provision of Section 2d similarly taxes electricity generated within the state and sold in regulated transactions. Those provisions do not discriminate against interstate commerce either facially or in fact. The question of "internal consistency," therefore, need not even be reached in this case.

In any event, the 1978 Act does not flunk the test of "internal consistency." Appellants make two arguments to the contrary, one purportedly factual and the other purely theoretical. Neither argument has merit.

Appellants *factual* argument proceeds as follows: electricity generated and sold within West Virginia bears a four percent West Virginia tax; electricity generated within but sold outside West Virginia bears a four percent West Virginia tax plus a sales tax, ranging from as little as two percent to as much as six percent, in the state of sale; therefore, electricity sold in

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generation as an interstate seller—a tax of four percent based on the cost of generation—plus a further amount of tax calculated at the same rate based on the costs of transmission and distribution for the privilege of conducting those further activities within the state.

interstate commerce bears a higher total burden of state taxation. J.S. 17. That argument is factually misleading and legally misguided.

The argument is misleading because appellants misrepresent both the character and the measure of West Virginia's tax under Sections 2d and 2m. The four percent tax imposed by Section 2d is not, as appellants would have it, a sales tax. The tax is measured by "sales and demand charges," but it is triggered not by the mere sale of electricity but by the generation and sale of electricity within the state; the sale of purchased electricity or of electricity generated outside the state is not subject to that tax. *See* note 8, *supra*.

Section 2m and the parallel provision of Section 2d impose a tax of four percent on the generation, transmission, and distribution of electricity, but only to the extent that those activities occur within the state. Consequently, electricity that is transmitted and distributed out-of-state bears less actual tax than that which is transmitted and distributed locally. Of course, electricity sold interstate may bear a sales tax in the state of sale, and that sales tax, when added to the tax paid under Section 2m, might result in a total tax burden higher than that borne by electricity sold intrastate. But it might not, depending upon the rate of sales tax in the state of sale and the method by which that tax is measured. It therefore cannot be said with certainty that electricity generated and sold within West Virginia bears less state tax than electricity generated within West Virginia but sold, for example, in Maryland.

Appellants' argument also is legally misguided: West Virginia's taxation of the generation of electricity is not unconstitutional merely because adjacent states impose sales taxes. This Court has expressly approved the result where one state "imposed a tax only upon manufacturing, while [another] imposed a tax only upon wholesaling." *Armco*, 467 U.S. at 645. Consequently, if West

Virginia taxed electricity generated and sold within the state, like that generated within but sold outside the state, only on the basis of the cost of generation, the result plainly would be constitutional. The fact that West Virginia actually recovers a further measure of tax from *intrastate* transactions, by including the costs of transmission and distribution in the measure of the tax, cannot by itself transform an otherwise constitutional state tax into one that impermissibly discriminates against *interstate* commerce.

Appellants' *theoretical* argument rests upon the notion that "[i]f every state were to adopt West Virginia's tax scheme, electricity manufactured in one state and sold in another state would bear the burden of two 4% taxes, whereas electricity manufactured and sold in the same state would bear the burden of only one 4% tax." J.S. 16. That notion is factually mistaken. Section 2d does not impose a tax of four percent on electricity generated out-of-state; imported power is treated as purchased power and is taxed, under a different provision of Section 2d, at the lower rate of three percent. *See* J.S. App. 12a.

The Supreme Court of Appeals correctly dismissed appellants' apparent suggestion that application of this three percent tax on the sale of imported power does not meet the test of "internal consistency." The Court noted that the issue is more hypothetical than real, for at most only "a negligible percentage of all of West Virginia's total power is imported." J.S. App. at 13a. In view of that, and because none of the appellants even claims to be subject to the tax on imported power, *id.* at 12a n.5, the Court concluded that any question concerning the propriety of the tax should "await[] a litigant with standing to challenge it and sufficient interest to develop a detailed factual record." *Id.* at 13a. If such a record, for example, established "that the cost of manufacturing electricity out-of-state is 25 percent of the cost of that electricity at the point of sale in this State,

. . . if every other state had exactly our *Code* 11-13-2d and 2m taxes, there would be perfect symmetry between interstate and intrastate commerce." *Id.* at 13a n.6. For these reasons, it would be premature to inquire into the propriety of West Virginia's taxation of imported power in this case.

2. *The Act does not deny equal protection.* Appellants argue that because Section 2m imposes a tax of four percent on the electricity that they generate within the state and sell elsewhere but not on electricity generated and sold within the state by public utilities in regulated transactions, they are being denied equal protection. J.S. 18-19. That argument is frivolous. Section 2d imposes tax at the same rate of four percent on the electricity generated and sold within the state by public utilities in regulated transactions. Sections 2d and 2m together tax at a uniform rate all electricity generated within the state for sale. Appellants are not being denied equal protection. Their invocation of *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869 (1986), therefore, is entirely beside the point.

Appellants' second argument with respect to equal protection concerns a statutory exemption from which they actually benefit and have no standing to challenge. A manufacturer that generates electricity within West Virginia for its own use inside the state is not required to pay a tax on the generation of that electricity. *See* W. Va. Code § 11-13-2b ("Section 2b"). Appellants contend that this exemption denies equal protection to manufacturers who generate electricity within West Virginia for their own use outside the state. J.S. 19-20. But appellants do not fall within that category, and the record does not disclose the existence of *any* manufacturer that generates electricity within West Virginia for its own use outside the state. The alleged discrimination appears to be purely hypothetical. What the record does disclose, however, is that appellants themselves benefit from the very

exemption that they seek to challenge. The tax they pay under Section 2m is calculated only on the basis of their "net generation," *i.e.*, the amount of electricity that they generate and transmit; because of the exemption in Section 2b, appellants are not required to pay tax on the amount of electricity that they generate for "station use," *i.e.*, for use in operating their own generating plants within the state. *See* Stip. Ex. Nos. 16-22. Because appellants benefit from and are not harmed by the exemption in Section 2b, they cannot be heard to challenge its validity. *See, e.g., Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 472 (1982).

CONCLUSION

The appeal should be dismissed or, in the alternative, the judgment of the Supreme Court of Appeals of West Virginia should be affirmed.

Respectfully submitted,

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APPENDIX

APPENDIX

CONSTITUTION AND STATUTES INVOLVED

Article I, Section 8, Clause 3 of the United States Constitution in pertinent part provides:

The Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States and within the Indian Tribes;

Section 1, Clause 4 of the Fourteenth Amendment to the United States Constitution provides:

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State where they reside. No State shall make or enforce any law which shall abridge the privileges or immunities or citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 2121(a) of the Tax Reform Act of 1976, 15 U.S.C. § 391 (1982), provides:

No State, or political subdivision thereof, may impose or assess a tax on or with respect to the generation or transmission of electricity which discriminates against out-of-State manufacturers, producers, wholesalers, retailers, or consumers of that electricity. For purposes of this section a tax is discriminatory if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce.

W. Va. Code § 11-13-2 (1978) in pertinent part provides:

There is hereby levied and shall be collected annual privilege taxes against the persons, on account of the business and other activities, and in the amounts to be determined by the application of rates against values or gross income as set forth in sections two-a and two-m, inclusive, of this article.

If any person liable for any tax under sections two-a, two-b, two-l or two-m shall ship or transport his products or any part thereof out of the state without making sale of such products, the value of the products in the condition or form in which they exist immediately before transportation out of the state shall be the basis for the assessment of the tax imposed in said section, except in those instances in which another measure of the tax is expressly provided. The tax commissioner shall prescribe equitable and uniform rules for ascertaining such value. . . .

W. Va. Code § 11-13-2b (1978) in pertinent part provides:

Upon every person engaging or continuing within this State in the business of manufacturing, compounding or preparing for sale, profit, or commercial use, either directly or through the activity of others in whole or in part, any article or articles, substance or substances, commodity or commodities, or newspaper publishing (including all gross income or proceeds of sale from circulation and advertising), except electric power produced by public utilities or others, the amount of the tax to be equal to the value of the article, substance, commodity or newspaper, manufactured, compounded or prepared for sale, as shown by the gross proceeds derived from the sale thereof by the manufacturer or person compounding or preparing the same, except as otherwise provided, multiplied by a rate of eighty-eight one-hundredths of one percent. The measure of this tax is the value of the entire product manufactured, compounded or prepared in the State for sale, profit or commercial use, regardless of the

place of sale or the fact that deliveries may be made to points outside the State. The value of electricity generated by persons taxed under the provisions of this section, which electricity is directly used by such persons in the business of manufacturing and not sold or otherwise transferred or transmitted to others, shall be exempt from the imposition of any tax under this article. . . .

W. Va. Code § 11-13-2d (1978) in pertinent part provides:

Upon any person engaging or continuing within this State in any public service or utility business, except railroad, railroad car, express, pipeline, telephone and telegraph companies, water carriers by steamboat or steamship and motor carriers, there is likewise hereby levied and shall be collected taxes on account of the business engaged in equal to gross income of the business multiplied by the respective rates as follows: . . . electric light and power companies, four percent on sales and demand charges for domestic purposes and commercial lighting and four percent on sales and demand charges for all other purposes, except as to income received by municipally owned plants producing or purchasing electricity and distributing same: Provided, that electric light and power companies which engage in the supplying of public service but which do not generate or produce electric power shall be taxed on the gross income derived therefrom at the rate of three percent on sales and demand charges for domestic purposes and commercial lighting and three percent on sales and demand charges for all other purposes, except as to income received by municipally owned plants: Provided, however, that the sale of electric power under this section shall be taxed at the rate of two and forty-six hundredths percent on that portion of the gross proceeds derived from the sale of electric power to a plant location of a customer engaged in a manufacturing activity, if the contract demand at such plant location exceeds two hundred thousand kilowatts per hour per year, or if the usage at such plant location

exceeds two hundred thousand kilowatts per hour in a year; . . . . The measure of this tax shall not include gross income derived from commerce between this State and other states of the United States or between this State and foreign countries. The measure of the tax under this section shall include only gross income received from the supplying of public services. The gross income of the taxpayer from any other activity shall be included in the measure of the tax imposed upon the appropriate section or sections of this article.

W. Va. Code § 11-13-2m (1978) provides:

(1) Upon every person engaging or continuing within this State in the business of generating or producing electric power for sale, profit or commercial use, either directly or through the activity of others, in whole or in part, when the sale thereof is not subject to tax under section two-d of this article, the amount of the tax to be equal to the value of the electric power, as shown by the gross proceeds derived from the sale thereof by the generator or producer of the same multiplied by a rate of four percent, except that the rate shall be two and forty-six hundredths percent on that portion of the gross proceeds derived from the sale of electric power to a plant location of a customer engaged in a manufacturing activity, if the contract demand at such plant location exceeds two hundred thousand kilowatts per hour per year, or if the usage at such plant location exceeds two hundred thousand kilowatts per hour in a year.

(2) The measure of this tax shall be the value of all electric power generated or produced in this State for sale, profit or commercial use, regardless of the place of sale or the fact that transmission may be to points outside this State: Provided, that the gross income received by municipally owned plants generating or producing electricity shall not be subject to tax under this article.